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SUBJECT: BOLIVIAN INFLATION: PRESSURE FROM ALL SIDES

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Summary  
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¶1. (U) After two decades of stable prices, Bolivia is headed toward double digit inflation. For the first nine months of the year inflation came in at 8.3 percent; it is likely to top 12 percent for the year. Skyrocketing remittances, narco trafficking, Venezuelan checks, favorable terms of trade, and expanding public spending are all contributing to high inflation, according to experts. Central bank responses appear inadequate and price controls will be of little, long term help. Moreover, investment is timid at best and unlikely to absorb much of the excess liquidity. End Summary.

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Remittances  
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¶2. (SBU) In May, the Bolivian Central Bank published a report estimating that remittances from Bolivians living abroad would reach \$700 million this year. That figure equates to a whopping 8% of GDP and about a 25% increase from ¶2006. Moreover, the figure could be even higher. The general manager of Banco Economico, the seventh largest bank in terms of deposits, said that their bank alone has handled over \$200 million this year and thus puts the figure at closer to \$1.2 million nationwide. Point being, remittances are putting a lot of cash into the hands of consumers.

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Narco Dollars  
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¶3. (U) Estimates clearly vary, but by all local accounts (especially in the Santa Cruz area) narco dollars are flowing freely into the economy. A good guess, based on coca leaf production, indicates that approximately US\$140-180 million enters the Bolivian economy through the drug trade. While a good remedy for altitude sickness, coca tea cannot reduce the inflationary headache these illicit inflows create.

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## Venezuelan Checks

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¶4. (U) In the Morales administration's version of transparency, the President has traveled over the past three months openly distributing checks from Venezuela. In order to avoid any government oversight, these checks are funneled directly through Morales as gifts from Chavez to local government leaders and even private contractors. The amounts are not insignificant. On October 14th, for example, Morales delivered two million dollars worth of checks in the city of El Alto. When he was unsure who the recipients should be, he simply asked the crowd if he should give the checks to the local government or the private contractor responsible for the intended projects (the crowd voted for the contractor).

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## Terms of Trade

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¶5. (U) Since last August, Bolivia has accumulated a trade surplus of approximately \$780 million dollars, or about 9% of GDP. (Note: This surplus is strictly a result of price increases; production from the gas (-1.5%) and mining (-12%) sectors have fallen in the first trimester of 2007). The result is the accumulation of over \$5 billion in monetary reserves through August. This sum is 1.2 times the quantity of reserves held in December 2006 and double the level in December 2005. Thus, while investment in the export sectors is low and production is falling, earnings are high. As one forward-looking national banker described it, Bolivia is living "a crisis of the bonanza."

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## Government Spending

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¶6. (U) Currently the fiscal situation in Bolivia is on solid ground. Favorable exterior conditions and debt forgiveness from international creditors have allowed the GOB to reduce its public debt to 32% of GDP, a considerable reduction from a high of 60% in 2004. Moreover, as of July, the government budget showed a surplus of close to four percent. Despite these positive fiscal numbers, the bonanza times for Bolivian exports have also allowed the GOB to increase public spending by about 40% through May. Quite simply, there is a lot of cash flowing through both the private and public sectors.

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## Central Bank Responses

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¶7. (U) The Central Bank has responded to excess liquidity by allowing the local currency to appreciate, taxing remittances by 1%, and attempting to sterilize some liquidity by selling bonds. Through 2005, the Central Bank issued 91 million in bonds. This figure rose to US\$249 by December of 2006 and jumped to US\$850 million by September 2007. Clearly, inflation is on the Central Bank's agenda and their concern is evidenced by the tripling of outstanding bonds over the last nine months. However, these sterilization measures contrast with a steadily increasing monetary supply. From 2005 to 2007 (through June), the monetary supply has grown by about 30% each year. This is not a sure indicator of inflation to come, but it is an additional pressure.

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## Comment

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¶8. (SBU) Bolivia is not alone in facing increasing inflationary pressure. To the south in Argentina, inflation has become the major issue in the presidential campaign; it

will likely only grow in importance in Bolivia as well. The Morales Administration is facing significant challenges across a broad spectrum of social and political issues, it can ill afford to be seen as mismanaging the economy. While many of the inflationary pressures that affect Bolivia are not the result of government policy, high inflation disproportionately impacts the poor (Morales' base) and they are unlikely to look beyond their government for causes. The economy matters and nothing brings that home faster than rising prices.

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